Key Distinctions between LIBOR Rate Setting and Oil and Energy Market Price Reporting

Much of the proposed European regulation of benchmarks is in response to the LIBOR scandal. LIBOR rate setting is distinctly different than oil and energy market price reporting by Independent Price Reporting Organizations (IPROs).

INDEPENDENCE

- **LIBOR: Prior to reforms, Not Independent.** LIBOR was overseen by the British Bankers Association (BBA) Foreign Exchange and Money Markets Committee which was comprised of representatives of the banks that contributed to LIBOR indices. These same banks had a vested interest in the end value of LIBOR because they were trading on the financial instruments referencing LIBOR. As a response to market manipulation of the benchmark, on April 1, 2013, the UK Financial Conduct Authority began supervising LIBOR. After a bidding process, an administrator was appointed by the UK government, to administer LIBOR in an independent manner.
  - The banks that contribute to LIBOR indices still have a vested interest in the rates reported.
- **IPROs:** There are three major independent price reporting organizations (IPROs) covering the physical commodity markets.
  - IPROs have no vested interest in the oil and energy markets and are not market participants in that they do not buy and sell or execute trades. The use of the price assessments they provide is voluntary, as are the submissions.

METHODOLOGY

- **LIBOR:** The goal of the LIBOR administrator is to eventually base LIBOR on an underlying market as opposed to estimates of a market.
  - LIBOR is created through a process whereby banks on a panel submit estimates to the administrator of the rate they could borrow funds before the market opens the next day. Different currencies have different banks on the panel that contribute price estimates. For example, for the United States Dollar (USD), there are 18 contributing banks on the panel. Once all of the data is received, the price estimates are ranked in descending order with the highest 25 percent and the lowest 25 percent excluded. The remaining estimates are then averaged to estimate LIBOR for a given currency. Using the USD as an example, only 10 rate estimates would be averaged after the top 4 highest rates and lowest 4 rates are excluded.

- **<u>IPROs</u>:** IPROs assess markets based on <u>observed</u> transactional data that are subject to verification and tested against real market conditions to ascertain reliability. The methodology used to assess the markets is <u>transparent</u>. IPROs can and do exclude contributions that do not meet the established standards. In addition, information is published as it is received which allows it to be tested by market.

MARKET TYPE

- **<u>LIBOR</u>:** LIBOR is a part of the <u>financial</u> markets.
- **<u>IPROs</u>:** IPROs' assessments are primarily on the <u>physical</u> commodity markets, which are distinct from financial markets. Physical oil is complex, heterogeneous and non-fungible.

COMPETITION

- **<u>LIBOR</u>: Not Competitive.** LIBOR indices are the product of a <u>single</u> organization <u>without</u> competition.
- **<u>IPROs</u>: Competitive.** Physical oil price assessments come from <u>numerous</u> organizations, including IPROs which operate in a <u>competitive</u> market. IPROs compete to provide users with price assessments based on many factors, including the reliability of their oil price assessments.